

8 Escrow

An escrow is essentially a small and short-lived trust arrangement. It has become almost an indispensable mechanism in this state for the consummation of real property transfers and other transactions such as exchanges, leases, sales of personal property, sales of securities, loans, and mobilehome sales. This chapter discusses the real estate sale escrow.

DEFINITION

California Civil Code Section 1057 provides this description of an escrow:

“A grant may be deposited by the grantor with a third person, to be delivered on the performance of a condition, and, on delivery by the depository, it will take effect. While in the possession of the third person, and subject to condition, it is called an escrow.”

And, in Section 17003 of the Financial Code:

“Escrow means any transaction wherein one person, for the purpose of effecting the sale, transfer, encumbering or leasing of real or personal property to another person, delivers any written instrument, money, evidence of title to real or personal property, or other thing of value to a third person to be held by such third person until the happening of a specified event or the performance of a prescribed condition, when it is then to be delivered by such third person to a grantee, grantor, promisee, promisor, obligee, obligor, bailee, bailor, or any agent or employee of any of the latter.”

ESSENTIAL ELEMENTS

The two essential requirements for a valid sale escrow are a binding contract between buyer and seller and the conditional delivery of transfer instruments to a third party. The binding contract can appear in any legal form, including a deposit receipt, agreement of sale, exchange agreement, option or mutual escrow instructions of the buyer and the seller.

ESCROW HOLDER

An escrow holder is the depository, agent, or impartial third person having and holding possession of money, written instruments, or personal property to be held until the happening of designated conditions. (Once these conditions are met and performed the escrow agent is generally released from liability.) According to Financial Code Section 17004, “escrow agent” is any person engaged in the business of receiving escrows for deposit or delivery.

The escrow holder acts to ensure that all parties to the transaction comply with the terms and conditions of the agreement as set forth in the escrow instructions. The escrow holder may also coordinate the activities and professional services involved in the transaction, such as the activities of the lender and the title company as well as those between the buyer, seller and broker.

INSTRUCTIONS

The conditional delivery or transfer is accompanied by instructions to the escrow holder to deliver the instruments and funds respectively on the performance of the stipulated

conditions. There are two forms of escrow instructions employed: bilateral (i.e., binding on both buyer and seller) and unilateral (separate instructions of buyer and seller). Since the escrow instructions implement and may also supplement the original contract, both are interpreted together if possible. If, however, the instructions contain terms in conflict with the original contract, the instructions, constituting the later contract, usually control.

When instructions have been signed by the parties to the escrow, neither party may unilaterally change the escrow instructions. The parties may, by mutual agreement, change the instructions at any time and one party may waive the performance of certain conditions, provided the waiver is not detrimental to the other party to the transaction.

While an escrow holder can be held liable for violating written instructions, the escrow holder is really only a stakeholder, not legally concerned with controversies between the parties. As such, an escrow holder is entitled to file an action of interpleader to require litigation of controversies.

COMPLETE ESCROW

Properly drawn and executed escrow instructions become an enforceable contract. An escrow is termed “complete” when all the terms of the instructions have been met.

ESCROW PRINCIPLES

The following are major escrow principles:

1. Escrow instructions must contain mutuality and the understanding of the principals to the escrow. Properly drawn instructions are clear and certain as to the intentions of the parties, the duties of the escrow holder, and the fact that it is the principals themselves who must perform the escrow contract by complying fully with the instructions. The escrow holder does not have, and must not exercise, *discretionary* authority.
2. The escrow holder does not act as a mediator or advisor, or participate in customer controversy, or arbitrate disputes. Instructions are drawn so that the parties to the escrow make the promises, perform, and put the escrow holder in a position to close the escrow.
3. The escrow holder is prohibited from offering legal advice and must suggest that disagreeing parties consult an attorney (or real estate broker if it is a transaction matter that may be negotiated).
4. Escrow is a limited agency relationship governed by the content of the escrow instructions. As agent for *both* parties, the escrow holder acts only upon specific *written* instructions of the principals. When the escrow is closed, the escrow holder becomes agent for *each* principal with respect to those things in escrow to which the parties have respectively become completely entitled.
5. When all parties to the escrow have signed mutual (identically conforming) instructions, the escrow becomes effective. If only one party has signed, that party may terminate the proposed escrow at any time prior to the other party's signing.
6. The escrow holder must avoid vague or ambiguous terms and provisions in instructions and documents.
7. The escrow holder must forward immediately to the title company any document which is to be recorded and furnish a copy to any concerned party, so that the document's sufficiency can be determined. This will help avoid delay in closing escrow.

8. Documents and funds not contemplated by the escrow instructions should not be accepted by the escrow holder without authorization of the principals.
9. The escrow trust account must be maintained with extreme care. Overdrawn accounts (debit balances) are strictly forbidden.
10. Escrows are confidential in nature. The escrow holder must not give out any information to third parties concerning an escrow without approval of the escrow principals.
11. The escrow holder is the agent of the principals to the escrow. Legally, any facts known by the escrow agent are imputed to the principals. Any detrimental or new material information, previously undisclosed, made known to the escrow holder and affecting the principals should be disclosed to them for their instructions in the matter.
12. The escrow holder must maintain a high degree of trust, efficient customer service, and good customer relations.
13. The escrow holder must remain strictly neutral, not favoring either party. The escrow holder must not advise either party, as any gain to the one will likely be detriment to the other.
14. The escrow holder must maintain records and files on a daily basis, to be sure that a procedure is not overlooked. Neat and orderly files, complete with check sheets, will help insure smooth progression toward closing.
15. Before closing an escrow, the escrow holder must audit the file, accounting for all items to be handled, recorded and delivered, including cleared funds.
16. The escrow holder must not disburse any funds from an escrow account until all items such as checks, drafts, etc. have cleared, and thus have become available for withdrawal. This "holding period" may range from 1 to 10 days, depending on the type and location of lender.
17. Closing and settlement must be prompt, using forms which are simple and clear.

GENERAL ESCROW PROCEDURES (*may vary according to local custom*)

Basic escrow procedures include the following:

1. ***Prepare Escrow Instructions*** on the escrow holder's printed form. All principals to the escrow sign instructions which fully set forth the understanding of the parties to the transaction. Usually accompanied by an initial deposit. For a home purchase, the mutual instructions of the principals set forth:
 - the purchase price and terms;
 - agreement as to mortgages;
 - how buyer's title is to vest;
 - matters of record subject to which buyer is to acquire title;
 - inspection reports to be delivered into escrow;
 - proration adjustments;
 - date of buyer's possession of the property;
 - documents to be signed by the parties, delivered into escrow, and recorded;
 - disbursements to be made, costs and charges and who pays for them; and
 - date of closing.

2. ***Order Title Search*** on the subject property, resulting in a “Preliminary Report” from the title company. The escrow holder examines this report carefully for items not contemplated in the escrow instructions. The seller must clear any such item or it must be brought to the attention of the buyer “for information” and “expression of desire in the matter.”
3. ***Request Demands and/or Beneficiary Statements*** from any lenders of record. The necessary document will be:
 - a “Demand for Pay-off” if an existing loan is to be paid in full through escrow; or
 - a “Beneficiary Statement” if buyer is purchasing “subject to” or assuming a loan.
4. ***Accept Structural Pest Control Report and Other Reports*** (such as plumbing or roofing inspections) into escrow and obtain, as instructed, any necessary approvals from the parties in connection with the reports/inspections. Hold the reports (and any funds associated therewith) for delivery to the proper party, or recording, at close of escrow.
5. ***Accept New Loan Instructions and Documents*** if the buyer is obtaining new financing. Obtain buyer’s approval/execution of the documents. Satisfy all lender’s instructions prior to using the lender’s funds to complete the transaction.
6. ***Accept Fire Insurance Policies and Complete Settlement*** by:
 - accepting and delivering any fire insurance policy and transferring the insurance if so instructed by the parties;
 - making all prorations (e.g., property taxes and insurance) as instructed by the parties;
 - completing the accounting (settlement) details and informing the principals that escrow is ready to proceed.
7. ***Request Closing Funds***. The law prohibits disbursement of funds from an escrow account until all items such as checks, drafts, etc. have cleared and become available for withdrawal.
8. ***Audit File in Preparation for Closing*** by:
 - accounting for all funds (Cash Reconciliation Statement) and documents;
 - determining that the parties have complied with all escrow instructions.
9. ***Order Recording*** by authorizing the title company to run the seller’s title to date and record the necessary documents, provided no change has occurred in the seller’s title since issuance of the preliminary title report.
10. ***Close Escrow***, after confirming recording, by:
 - preparing settlement statements for buyer and seller;
 - disbursing all funds; and
 - delivering documents to the party or parties entitled thereto.

PRORATION

The seller is the beneficial owner of the property until close of escrow. If possession is delivered at some time other than at the close of escrow, the principals may agree to adjust the proration date since possession normally indicates beneficial ownership. If possession is delivered sometime after close of escrow, the parties may agree to proration

of taxes, rent and/or assessments, along with prepaid items for which the buyer becomes responsible upon recording of the deed, such as interest on a new loan or prepaid fire insurance obtained by buyer.

TERMINATION

Escrows are voluntarily completed by full performance and closing or terminated by mutual consent and cancellation. It has been held that compliance with escrow instructions must be achieved within the time limit set forth in the escrow agreement and the escrow holder has no authority to enforce or accept performance after the time limit provided in the instructions. When the time limit provided in the escrow instructions has expired and either party to the escrow has not performed in accordance with the terms of the escrow agreement, the parties may cancel escrow and are entitled to the return of their respective property and documents. The escrow holder does not have authority to determine that a principal has not performed. Therefore, clear and precise instructions from the principals are necessary.

CANCELLATION OF ESCROW - CANCELLATION OF PURCHASE CONTRACT

Cancellation of escrow may not also cancel a purchase contract. In *Cohen v. Shearer* (1980) 108 C.A. 3d 939, a Court of Appeal decided that cancellation of an escrow by mutual agreement of the parties did not rescind the purchase contract between them.

Therefore, a real estate broker seeking to carry out the principal's decision to cancel a contract of purchase or sale should be sure the other party to the contract agrees in writing to do precisely that and not simply settle for written advice to cancel the escrow. As happened in the *Cohen* case, if a purchase agreement is not canceled along with the escrow, either party to the agreement may retain the right to specific enforcement of the contract or for the recovery of damages.

WHO MAY ACT AS ESCROW AGENT

The Escrow Law (Division 6 of the California Financial Code) provides that escrow agents must be licensed by the Commissioner of Corporations. However, banks, savings and loan associations, title insurance companies, trust companies, attorneys and real estate brokers have exemptions from the licensing requirements of the Escrow Law.

The exemption for real estate brokers [Section 17006 (a)(4) of the Financial Code] applies to any broker licensed by the Real Estate Commissioner while performing acts in the course of or incidental to a real estate transaction in which the broker is a party or in which the broker is an agent performing an act for which a real estate license is required.

The Department of Corporations has interpreted Section 17006 (a)(4) to mean that:

1. the exemption is personal to the broker and the duties, other than ministerial functions, cannot be delegated by the broker;
2. in a purchase and sale transaction, if the broker is not a party, he must be the selling or listing broker;
3. the exemption is not available for any association with other brokers for the purpose of conducting escrows; and
4. when the broker's escrow business is a substantial factor in the utilization of the broker's services, the escrow business is not "incidental to a real estate transaction."

A broker cannot advertise that he or she conducts escrows without specifying in the advertisement that such services are only in connection with the broker's real estate brokerage business.

A broker may not use a fictitious name or a corporate name containing the word "escrow," or advertise in any other manner which would tend to be misleading to the public.

A real estate broker who conducts an escrow under the exemption must maintain all escrowed funds in a trust account and keep proper records. The broker must follow the provisions of Commissioner's Regulations 2950 and 2951.

Escrow Companies Must Be Incorporated

An individual cannot be licensed as an escrow agent. A corporation duly organized for the purpose of conducting an escrow business must hold the license. Applicants for escrow licenses must be financially solvent and furnish a surety bond in the amount of \$25,000 or more, based upon yearly average trust fund obligations. All officers, directors, trustees, and employees having access to money or negotiable securities in the possession of the corporate licensee must furnish a bond of indemnification against loss. All money deposited in escrow must be placed in a trust account which is exempt from execution or attachment.

AUDIT

An escrow agent is required to keep accurate accounts and records which are subject to examination by the Commissioner of Corporations. The corporation must also, at its own expense, submit annually an independent audit prepared by a Certified Public Accountant or Public Accountant.

PROHIBITED CONDUCT

No escrow agent licensee may disseminate misleading statements or describe as an "escrow" any transaction which is not included under the definition of "escrow" in the Financial Code.

A licensed escrow agent may not pay fees to real estate brokers or others for referral of business. Such prohibited "fees" would include gifts of merchandise or other things of value.

An escrow agent cannot disburse a real estate broker's commission prior to closing of the escrow.

Escrow licensees may not solicit or accept escrow instructions, or amended or supplemental instructions, containing any blank to be filled in after signing or initialing. They may not permit any person to make any addition to, deletion from, or alteration of an escrow instruction unless it is signed or initialed by all persons who had signed or initialed the instructions. Escrow licensees are charged by law with delivering, at the time of execution, a copy of any escrow instruction, or amended or supplemental instruction, to all persons executing it. However, escrow instructions, being confidential, may not be disclosed to nonparties.

A real estate broker may not nominate an escrow holder as a condition precedent to a transaction, but may suggest an escrow holder if requested to do so by the parties.

RELATIONSHIP OF THE REAL ESTATE BROKER AND THE ESCROW HOLDER

A real estate broker should always consult the escrow officer before telling the principals that escrow will close on a certain date. An escrow includes a myriad of details, any of which could cause delay. Submission of accurate documents will expedite closing. Some suggestions:

1. As far as possible, make certain that the deposit receipt reflects the entire intentions of the principals.
2. When opening escrow, bring the recorded grant deed whereby the seller acquired the property or the seller's title policy. These documents establish the correct legal description and the manner in which seller holds title to the property.
3. Remember that all escrow instructions and amended instructions must be in writing. If the buyers are planning to be away, the broker should check with the escrow officer before they leave to determine if their absence will in any way hold up closing of escrow. If a small amount of money is due from the buyers, the broker cannot offer to put up the money or instruct the escrow officer to deduct the amount from the broker's commission. The escrow officer cannot do this. The buyer may be deliberately withholding the deposit of closing funds until seller performs some condition known only to the principals. To accept "buyer's closing funds" from any party other than buyer is to force an escrow to close against the understanding of the parties.
4. Furnish escrow with the correct spelling of buyer's name, address and telephone number. Buyer's and seller's business phone numbers should be included.
5. Be sure the escrow officer knows how buyer wants to take title. Brokers, salespersons or escrow officers should not assist with this decision, as it may involve legal and tax consequences.
6. Give escrow holder names and addresses of all lenders or loan servicing agents and the loan numbers. Many lenders, and FHA, require a 30-day advance payoff notice or seller may be subject to additional charges on any loan payoff.
7. Check with the seller regarding bonds or other liens on the property. Those not being assumed may be paid before opening the escrow.
8. If new financing has not been arranged before escrow is opened, notify the escrow officer immediately when the loan has been obtained.
9. Before escrow is opened, determine how fire insurance is to be handled. (The buyer may want to do business with buyer's insurance agent or a certain company. The seller's policy may include other property and the seller may not want it transferred or totally canceled.)
10. Be aware of the escrow holder's time requirement relating to non-cash deposit of funds. Checks must clear before the escrow holder can make disbursements.

DESIGNATING THE ESCROW HOLDER

Because selection of an escrow holder is not usually critical to either principal in a transaction, real estate brokers have in the past played a large role in deciding where a transaction would be escrowed. In recent years, however, there has been an increasing effort on the part of federal and state regulators to minimize the influence of the broker in selection of the escrow holder. The rationale is that buyers and sellers have the right, and

should have the opportunity, to compare escrow services and charges and, if they so desire, negotiate between themselves as to where escrow will be held.

DEVELOPER CONTROLLED ESCROWS - PROHIBITION

Civil Code Section 2995 prohibits any real estate developer (defined as any person or entity having an ownership interest in real property which is improved by such person or entity with single-family dwellings which are offered for sale to the public) from requiring, as a condition precedent to the transfer of real property containing a single-family residential dwelling, that escrow services effecting such transfer be provided by an escrow entity in which the developer has a “financial interest.” The phrase “financial interest” means ownership or control of 5 percent or more of the escrow entity. A developer who violates this statute is liable for damages of \$250 or three times the charge for escrow services, whichever is greater, plus attorney’s fees and costs. Any waiver of this prohibition is against public policy and therefore void.